PRIVATE POWER AND INTERNATIONAL LAW: THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION*

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International lawyers have traditionally been interested in public power, i.e. ability to influence substantive outcomes across national borders through state coercion or threat thereof. They have been (and continue to be) engaged in debates about ways in which that type of power can be limited or, at the very least, made accountable. More recently international lawyers have also developed an interest in private power, i.e. ability to influence substantive outcomes across national borders without the use of state coercion or threat thereof. This paper explains how accountability for exercise of private power is achieved using the International Swaps and Derivatives Association (ISDA) as an example. ISDA's accountability consists of a combination of procedural Global Administrative Law-like standards applicable to ISDA itself as well as legislative, regulatory and judicial recognition of the market conventions developed by ISDA. This model of accountability makes ISDA responsive to both cosmopolitan and national constituencies.

Keywords: ISDA, derivatives, accountability

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I. INTRODUCTION

International lawyers have traditionally been interested in public power, i.e. the ability to influence substantive outcomes across national borders through state coercion or threat thereof.[1] They have been (and continue to be) engaged in debates about ways, in which that type of power can be limited or, at the very least, made accountable. More recently international lawyers have also developed an interest in private power, i.e. ability to influence substantive outcomes across national borders without the use of state coercion or threat thereof. Here the debate concerns the role of international law in limiting and making private power accountable.[2] The argument in favor of subjecting private power to international law is particularly strong in areas where the exercise of private power across national borders causes perceived injustice and other mechanisms of accountability may be absent.

In the realm of finance activities of transnational private organizations, industry associations in particular have important implications for justice and oftentimes remain unaccounted for under domestic law. The International Swaps and Derivatives Association (ISDA) provides an example. At least two types of justice-like concerns have been articulated with regard to ISDA. First, over-representation of the so-called sell-side institutions (banks, dealers) within ISDA's governance structure.[3] Second, the effects of the close-out netting provision of the ISDA Master Agreement, which privileges derivatives

[1] Cf Richard H Steinberg and Jonathan M Zasloff, 'Power and International Law' (2006) 100(1) American Journal of International Law 64, analyzing the range of stances on the relationship between power and international law that have appeared in the journals the last century.

[2] The use of the US Alien Torts Statue to invoke international law against private corporations is illustrative of that trend. See 28 U.S.C. § 1350 (2006). The statute states in its entirety: 'The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'. In *Kiobel v. Royal Dutch Petroleum* 621 F.3d 111, 150 (2d Cir. 2010) the U.S. Court of Appeals for the Second Circuit rejected corporate liability under ATS.. This decision has been upheld by the US Supreme Court in *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659 (2013). At the same time the trend to use international law against private parties can be seen in other jurisdictions as well. See eg Peter Muchlinski, 'The Changing Face of Transnational Business Governance' (2011) 18 Ind. J. Global Leg. Stud. 665, 687–88, discussing recent cases in continental Europe where corporations have been defendants in suits claiming the corporations are liable for environmental damage, human rights abuses and war crimes.

[3] See Frank Partnoy and David A Skeel Jr, 'The Promise and Perils of Credit Derivatives' (2007) 75(3) U. CIN. L. REV. 1019, 1039. See also Gillian Tett, 'Calls for radical rethink of derivatives body' Financial Times (26 August 2010).

in bankruptcy.[4] It is against the backdrop of these concerns that calls for greater accountability of the organization ensued.

Accountability is a measure of a certain type of legitimacy, one that testifies to the 'responsiveness' of the regime to a relevant constituency, i.e. the one that could be affected by its activities.[5] Private organizations, such as ISDA, are not oblivious to the challenge of accountability, but they may have a difficulty in identifying the relevant constituency to which they *could* and *should* be accountable and means through which this could be done. These difficulties are compounded in the transnational context, where the relevant constituency and the means of doing that are even more difficult to conceptualize.

It seems therefore that there exists a gap, a conceptual gap, in our thinking about accountability for exercise of private power in a transnational context. This gap in our theories of accountability is the starting point for this paper. It will be argued here that this gap is problematic from a normative standpoint, because the failure to develop conceptualizations of accountability and legitimacy of private organizations limits our ability to understand how outcomes are produced and how actors are differentially enabled and constrained in global governance. The question thus arises: how to address this dimension of transnational governance?

This paper uses the Global Administrative Law approach to explain how ISDA achieves accountability. It first outlines the nature of the power exercised by ISDA (section 2), and identifies the GAL principles of accountability - transparency, rationality and legality and effective review (section 3). Section 4 explains how ISDA strives to achieve those normative standards through a combination of procedural GAL-like standards applicable to ISDA itself as well as legislative, regulatory and judicial recognition of the market conventions contained in the documentation developed by ISDA, and in particular the ISDA Master Agreement. This model of accountability makes ISDA responsive to both cosmopolitan and national constituencies.

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[4] See eg Patrick Bolton and Martin Oehmke, 'Should Derivatives Be Privileged in Bankruptcy?' (2013) Journal of Finance. See also Stephen J Lubben, 'Too Much Protection for Derivatives in Bankruptcy' New York Times (11 September 2012).

[5] See eg Ronald J Oakerson, 'Governance Structures for Enhancing Accountability and Responsiveness', in J L Perry (ed) *Handbook of Public Administration* (1989), 114 ('[t]o be accountable means to have to answer for one's action or inaction, and depending on the answer, to be exposed to potential sanctions, both positive and negative.').

II. ISDA: A POWER ANALYSIS

It is perhaps the cornerstone feature of every legal system that it legitimates the exercise of power. Accountability is one dimension of that legitimation, one that makes those who exercise power responsive towards those against whom power is exercised.

Power is not always easily recognized. When the United States Congress enacts a massive piece of legislation such as the Dodd-Frank Act, the source, but also the limits, of its power are clear. The source, the limits and, for that matter, the nature of power of organizations like ISDA are much less straightforward. As Horatia Muir Watt recently noted in her criticism of classical approaches in public and private international law:

> [t]he most spectacular convergence of denials by public and private international law concerns the forms of private power exercised in the global economy by non-sovereign entities such as multinational corporations or rating agencies. In spite of their significant role in shaping of the global market, these entities escape any credible form of public accountability or private responsibility.[6]

This is problematic – suggests Professor Muir Watt – because as long as private power is not recognized it cannot be made subject to adequate treatment under the law.[7] Recognition of private power under the law requires a good understanding of how power operates, including how it operates in the transnational context. This section of the paper tries to enrich our understanding of the different ways in which power operates in a transnational context, relying on the contributions of literature in political science.[8] The analysis will focus on the interactional and constitutive power that ISDA exercises.

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[6] Horatia Muir Watt, 'Private International Law Beyond the Schism', IILJ Working Paper 2012/1, referring to, *inter alia*, A Claire Cutler, *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* (CUP 2003), 14 and Dan Danielsen, 'How Corporations Govern: Taking Corporate Power Seriously in Transnational Regulation and Governance' (2005) 46(2) Harvard Journal of International Law 411-425.

[7] ibid.

[8] I rely in particular on Michael Barnett and Raymond Duvall, 'Power in International Politics' (2005) 59 INT'L ORG. 1, 39-75.

1. ISDA's Interactional Power

ISDA has pioneered efforts to identify various risks commonly encountered in markets and helped redistribute them more efficiently through derivatives. Derivatives are, in essence, contracts that facilitate the trading and redistribution of risk. They owe their name to the fact that their value is derived from an underlying asset, index, interest rate or another reference value. Since they redistribute risk, they can be used either to insure (hedge) oneself against a particular risk or, conversely, to take on risk (invest or speculate).[9] They can also be used to arbitrage between different markets.

The organization emerged from discussions held in New York in the early 1980s, led by Salomon Brothers – an investment bank – and other entities that were beginning to sell derivatives, in particularly swaps.[10] This group then employed the US law firm Cravath as well as the London firm Allen & Overy to advise them on how to proceed.[11] Over the following years the ISDA was formed. It has grown considerably and has by now become the most influential organization shaping the rules of derivatives markets. As of December 2014 it had over 800 member institutions from 67 countries.[12] These members include most of the world's major institutions that deal in privately negotiated derivatives,[13] as well as many of the businesses, governmental entities, investment managers and other end users that rely on over-the-counter (OTC) derivatives to manage the financial market risks inherent in their core economic activities.

The mission statement of ISDA identifies the organization's role as, inter alia, representing all market participants globally, promoting high standards of commercial conduct and leading industry action on derivatives issues.[14] The organization 'seeks to promote infrastructure that supports an orderly and reliable marketplace, as well as transparency to regulators; enhances counterparty and market risk practice; advances the effective use of central clearing facilities and trade repositories; and represents the derivatives

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[9] See Impact Assessment, Commission staff working document accompanying a proposal for regulation of derivatives, central counterparties and trade repositories, SEC(2010) 1058/2, available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_impact-_assessment_en.pdf (accessed 17 November 2012).

[10] A swap is the most basic, or "vanilla" type of a derivative traded in the so-called over-the-counter market between two private parties.

[11] For a discussion of the evolution of ISDA see eg Sean M Flanagan, 'The Rise of a Trade Association: Group Interactions Within the International Swaps and Derivatives Association' (2001) 6 HARV. NEGOT. L. REV. 211, 240.

[12] See http://www2.isda.org/about-isda/ (accessed 5 November 2012).

[13] A large portion of derivatives has been traditionally traded in the over-the-counter (OTC) markets, i.e. directly between two parties, without going through an exchange or other intermediary. Alternatively, derivatives can also be traded on exchanges.

[14] See http://www2.isda.org/about-isda/mission-statement/ (accessed 28 February 2015).

industry through public policy, ISDA governance, ISDA services, education and communication.'[15]

ISDA's power is, in the first place, *interactional* in the sense that it is 'shaped by behavioral relations or interactions, which, in turn, affect the ability of others to control the circumstances of their own behavior.'[16] Membership is the cornerstone feature that enables interactional power to be exercised.[17]

As Benedict Kingsbury et al suggest, in national law, private bodies such as ISDA are typically treated as clubs rather than as administrators, unless they exercise public power by explicit delegation.[18] 'But in the global sphere, due to

[15] ibid.

[16] 'The funny thing about ISDA is that thousands of people think of themselves as part of the Association. One of our Board members said he counted 200 people in his firm alone who were active in ISDA committees, working groups and projects. We count all who work in the industry as part of ISDA. We represent them and like to publicize progress, regardless of which entity actually did the work – as long as it makes our markets safer and more efficient.', 'DerivatiViews, Clearing, Compression and Customization', available at http://isda.derivativiews.org/2011/-11/01/clearing-compression-and-customization (accessed 28 February 2015).

[17] ISDA provides for three types of membership: primary (mostly for sell-side institutions), associate (law firms, accounting firms) and subscribed (buy-side institutions) membership. There are two types of benefits associated with the different categories of membership. The first type, which does not discriminate between the different categories, encompasses the possibility of participating in the Association's numerous committees and task forces which serve to address issues in derivatives market, the possibility of receiving policy papers, response letters, market survey data, and communications on key business issues that ISDA and its consultants generate as well as eligibility to receive the Association's legal opinions on the enforceability of the netting provisions of the ISDA Master Agreements, which enable institutions to reduce credit risk and consequently capital requirements in jurisdictions subject to BIS capital regulations. The second type of benefits, which does discriminate between members concerns voting rights. Only primary members are entitled to vote on all matters submitted to a vote of the membership. See Section 10 of ISDA Bylaws, available at https://www.isdadocs.org/membership/bylaws.pdf (accessed on 28 February 2015).

[18] Benedict Kingsbury, Nico Krisch and Richard Stewart, 'The Emergence of Global Administrative Law' (2005) 68 L. & CONTEMP. PROBS. 15, 23. These organizations often constitute what Hugh Collins calls 'club markets'. 'A club market is created by a group of traders for their mutual protection and to obtain efficiency gains through savings on transaction costs (...)The advantage of a club market is that it permits the expansion of membership of the trusted group and at the same time increases the potential severity of non-legal sanctions. The rudimentary form of a club market is that the members agree to be bound by the rules of the association'. Hugh Collins, *Regulating Contracts* (OUP 1999) 212. As Collins notes, 'club markets' were instrumental in creating derivatives, in particular futures markets. 'The club market can supply three essential ingredients for a futures market: first, a standardized, mandatory style of commodity description; secondly, a standardized mandatory contractual package of terms or entitlements; and third, a mechanism for creating an irrevocable and unimpeachable obligation'. ibid, 213.

the lack of international public institutions, they often have greater power and importance."[19] By involving powerful actors ranging from banks, through law firms to non-financial corporations, ISDA is able to influence behavior of (financial) markets through, in particular, development of standardized practices.

2. ISDA's Constitutive Power

ISDA's power is also *constitutive* in the sense that it produces the very social capacities of structural, or subject, positions in direct relation to one another, and the associated interests, that underlie and dispose action.[20] In other words, it is the power to constitute something new. It concerns the determination of social capacities and interests.[21] ISDA's constitutive power manifests itself perhaps most importantly in 1) development of documentation for the derivatives market; and 2) operations of its Credit Determination Committees.

A. Close-out Netting

Consider the role of the close-out netting provisions of ISDA's Master Agreement. As a general matter, netting refers to a process through which the ongoing obligations of parties to a transaction, or number of transactions, are determined by netting or aggregating obligations, with the difference between these two aggregates then producing a single settlement figure.[22] A netting agreement will in general be subject to the principle of the parties' freedom of contract, and there are no particular obstacles to its enforceability as long as both parties are solvent. However, the situation is very different in the event

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To the extent that these private actors operate on the basis of delegation it has been argued that the existing administrative structures are ill suited to oversee the sound exercise of judgment and discretion. See in particular Kenneth A Bamberger, 'Regulation as Delegation: Private Firms, Decisionmaking and Accountability in the Administrative State' (2005) 56(2) DUKE L. J. 377. Cf Martha Minow, Joody Freeman (eds), *Government by Contract: Outsourcing and American Democracy* (Harvard University Press 2009).

[19] Kingsbury et al, *The Emergence* (n 18), 23.

[20] Barnett and Duvall, 'Power in International Politics' (n 8).

[21] Cf ibid.

[22] This mechanism is provided for under s 2(c) of the MA, which reads:

> *Netting of payments.* If on any date amounts would otherwise be payable: - (i) in the same currency; and (ii) in respect of the same Transaction, by each party to the other, then, on such date, each party's obligation to make payment of any such amount will be automatically satisfied and discharged and, if the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, replaced by an obligation upon the party by which the larger aggregate amount would have been payable to pay to the other party the excess of the larger aggregate amount over the smaller aggregate amount.

of insolvency of one of the parties. In these cases bankruptcy law generally trumps parties' freedom of contract. This is why the special treatment of derivatives described above was needed to make netting enforceable in bankruptcy. ISDA has been very consistent that derivatives' exemptions from bankruptcy laws are entirely warranted in order to protect the health of the derivatives markets and the financial system as a whole. In particular 'ISDA posits that (...) a failure of a derivatives market player could prompt a destabilizing domino effect, threatening the positions of other market participants which might be intertwined in trades with the insolvent, ultimately generating systemic risk.'[23]

According to the express terms of section 2(a)(iii) of the ISDA Master Agreement, following the occurrence and during the continuance of an event of default, the non-defaulting party is not required to terminate the ISDA Master Agreement following an event of default, and it equally is not required to perform obligations under the ISDA Master Agreement. Instead, in accordance with Section 6 of the Master Agreement the non-defaulting counterparty may elect that the transaction be terminated early and calculate and 'net' the amounts owed.[24]

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[23] See David Mengle, 'The Importance of Close-Out Netting' (ISDA Research Notes, Number 1, 2010) available at http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf (accessed 2 December 2012).

[24] Section 6(a) of the ISDA MA reads:

> If at any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-defaulting Party") may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions.

Section 6(f) of the ISDA MA reads:

> Any Early Termination Amount payable to one party (the "Payee") by the other party (the "Payer"), in circumstances where there is a Defaulting Party or where there is one Affected Party in the case where either a Credit Event Upon Merger has occurred or any other Termination Event in respect of which all outstanding Transactions are Affected Transactions has occurred, will, at the option of the Non-defaulting Party or the Non- affected Party, as the case may be ("X") (and without prior notice to the Defaulting Party or the Affected Party, as the case may be), be reduced by its set-off against any other amounts ("Other Amounts") payable by the Payee to the Payer (whether or not arising under this Agreement, matured or contingent and irrespective of the currency, place of payment or place of booking of the obligation).

As it has been pointed out in the literature, close-out netting has complex economic implications, of both an individual and systemic nature.[25] From an individual perspective the potential beneficial effects are twofold: first, close-out netting can prospectively reduce counterparty risk, and, second, it can help both parties achieve a more favorable position in terms of the underlying capitalization. This is because by aggregating the amounts owed, both parties reduce their exposures towards their counterparties and thereby also reduce their need for regulatory capital.[26]

From a systemic point of view the use of close-out netting can prevent the risk of contagion from becoming systemic, i.e. affecting the financial market in such a way that it becomes dysfunctional.[27] This beneficial effect is grounded in the idea that close-out netting shields systemically important market participants from the consequences of their counterparty's insolvency. It has been cited as the principal justification for the special treatment afforded to derivatives in bankruptcy. [28]

In the past these benefits have been recognized by some of the most important global macroprudential oversight bodies, including the Cross-border Bank Resolution Group (CBRG) of the Basel Committee. In its 2010 report the CBRG mentions enforceable netting agreements in a list of mechanisms capable of mitigating systemic risk in the first place, along with collateralization, segregation of client assets and standardization and regulation of OTC derivatives transactions.[29] It called upon national authorities to promote the convergence of national rules governing the

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[25] See Robert R Bliss and George G Kaufman, 'Derivatives and Systemic Risk: Netting, Collateral and Closeout' (2006) 2 J. FIN. STAB. 1, 55-70.

[26] As Bliss and Kaufman argue, close out netting has evolved for purposes other than reducing systemic risk reduction. 'Market participants tend to be more concerned with their own welfare in normal day-to-day business environments than with possibilities of adverse externalities in the form of systemic failures of markets. Netting, close-out, l serve the needs of market participants even when there is no systemic threat: they facilitate market risk and counterparty credit risk management; and they permit expansion of dealer activities, enhancing the depth and liquidity of the derivatives markets." ibid,57.

[27] ibid

[28] Compare 11 U.S.C. § 560 (2006) ('The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title.').

[29] Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group (March 2010).

enforceability of netting agreements with respect to their scope of application and legal effects across borders.[30]

B. Credit Event Determinations Committees

Another example of ISDA's constitutive power comes from its Credit Determination Committees (CDC). For a long time CDC were established on an ad hoc basis, whenever there arose a question as to whether a default, triggering payment on a credit default swaps, has arisen. During the 2007-2008 financial crisis they have been "hard-wired" into the market infrastructure. They played an important role in the context of swaps on sovereign bonds, and thus had major public implications, perhaps most prominently in the context of credit default swaps (CDS) purchased by investors for protection from default of Greek sovereign bonds.

In 2009, after fifteen consecutive years of economic growth, Greece entered recession. By the end of 2009, the Greek economy faced the highest budget deficit and government debt to GDP ratios in the EU. The 2009 budget deficit stood at 15.4% of GDP. This, and rising debt levels (127% of GDP in 2009), led to rising borrowing costs, resulting in a severe economic crisis.[31] It is hardly surprising that under these circumstances many investors and banks that purchased Greek sovereign bonds also purchased Greek sovereign CDS to protect themselves against the risk of default. In a CDS, the buyer of protection pays a fee to obtain indemnification against the risk of default of a borrower (for example, Greece), and any resultant loss, from a protection seller. Payment is triggered by a "credit event", technically defined as failure to pay interest or principal, debt moratorium or repudiation or restructuring. However, around mid 2012 there was a lot of uncertainty among Greek CDS holders concerning what "restructuring" really means. The pressing question at the time was whether voluntary restructuring – entailing lenders agreeing to Greece exchanging existing bonds and loans for ones with different terms (longer maturity, different rates) – could be considered a credit event under the CDS.[32]

On 9 March 2012 the European, Middle Eastern and African section of the Credit Determination Committees (DCs) announced that a restructuring event had occurred with respect to Greece.[33] As one commentator for the

[30] ibid.

[31] http://ec.europa.eu/economy_finance/eu/countries/greece_en.html (accessed 5 November 2012).

[32] Gretchen Morgenson, 'Scare Tactics in Greece', New York Times (19 November 2011), available at http://www.nytimes.com/2011/11/20/business/credit-default-swaps-as-a-scare-tactic-in-greece.html (accessed 5 November 2012).

[33] See ISDA (Press release), 'ISDA EMEA Determinations Committee Accepts Question Related to a Potential Hellenic Republic (Greece) Credit Event' (9 March 2012)

Financial Times remarked: 'while perfectly legal, the ability of a private body of financiers and lawyers to determine whether or not there has been "default" is unusual and legally untested.'[34] The DCs comprise ISDA members who, in essence, have the biggest positions in any CDS contract under examination.[35]

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available at http://www2.isda.org/asset-classes/credit-derivatives/greek-sovereign-cds/ (accessed 5 November 2012). The Determinations Committee held that the invoking of the collective action clauses by Greece to force all holders to accept the exchange offer for existing Greek debt constituted a credit event under the 2003 ISDA Credit Derivatives Definitions. Those Definitions state that the Restructuring Credit Event is triggered if one of a defined list of events, such as bankruptcy, occurs, with respect to a debt obligation such as a bond or a loan, as a result of a decline in creditworthiness or financial condition of the reference entity. The listed events are: reduction in the rate of interest or amount of principal payable (which would include a "haircut"); deferral of payment of interest or principal (which would include an extension of maturity of an outstanding obligation); subordination of the obligation; and change in the currency of payment to a currency that is not legal tender in a G7 country or a AAA-rated OECD country. An important element of the definition of Restructuring is that the event has to occur in a form that binds all holders of the "restructured" debt. The DC found that the Greek debt restructuring plan involves a "haircut" and is binding on all holders of Greek debt. ISDA (Press release), 'Greek Sovereign CDS Credit Event Frequently Asked Questions (FAQ)' (9 March 2012) available at http://www2.isda.org/asset-classes/credit-derivatives/greek-sovereign-cds/ (accessed 5 November 2012).

[34] Satyajit Das, 'Final arbiter in Greek saga is untested, private body', FT.com (22 June 2011), available at http://www.ft.com/intl/cms/s/0/95e3131a-9bf9-11e0-bef9-00144feabdc0.html#axzz2BMvE6lyE (accessed 5 November 2012). See also Morgenson, 'Scare Tactics' (n 32), illustrating the conflicts of interests inherent in the activity of the DCs: 'One of the money managers who attended the meetings said Ms. Yang's presence seemed to raise a conflict. Ms. Yang works for BNP, which stands to profit from the restructuring. She is also on the I.S.D.A. panel, which will determine if credit default swaps pay off. One of the money managers said he pointed out Ms. Yang's dual role at a meeting. "You're on the determinations committee, your firm is earning a big fee and trying to scare me into tendering my bonds," he said he told her. He said Ms. Yang replied: "No, I'm just trying to help tell you what could go wrong."'.

[35] As for the sell side: 'There are separate criteria for membership on a DC depending on whether the member is a dealer or buy side member. To become a dealer member, the dealer institution must fulfill three requirements. First, the dealer must be a participating bidder in auctions. Second, the dealer must adhere to the "Big Bang" protocol. Last, the composition of dealer members will be based upon notional trade volumes as reported by Depository Trust and Clearing Corporation (DTCC) data via their Trade Information Warehouse (TIW).' As for the buy-side: 'To become a buy side member of a determination committee is a two-tier process. Buy side members of a DC will be randomly selected from a buy side pool. To qualify to be in the buy side pool, the institution must have at least $1 billion in assets under management (or the equivalent), have single name CDS trade exposure of at least $1 billion, and be approved by one-third (1/3) of the then-current buy side pool. The buy side members of the DC will be randomly selected from the buy side pool and serve for staggered one year terms. The buy side members on the DC must include at least one hedge fund and one traditional asset manager at all times. No institution can serve a second term until all eligible institutions have served. The proposal gives the buy side a direct voice and formal,

As such they are not independent bodies, neither institutionally nor in terms of the rules that they are bound to apply. The identity of each current (and past) CDC member for each region is made publicly available on the ISDA's website. Members tend to be chosen from among the most important actors, in particular large sell-side institutions.[36] They also tend to be the same across regions. Understandably, this has given rise to allegations that the members vote in a way that benefits their financial institutions rather than with regard to some objective standard.[37]

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permanent representation., The CDS Big Bang: Understanding the Changes to the Global CDS Contract and North American Conventions, Market (13 March 2009), available at http://www.markit.com/cds/announcements/resource-/cds_big_bang.pdf.

[36] The DC consists of 10 dealers and five buy-side firms. An 80% super-majority is needed to determine a credit event. CDC's resolutions are subsequently published on the website. The publication includes the determination itself, as well as (if appropriate) an auction timeline, a list of participating bidders, any related resolutions, a list of deliverable obligation, the particular auction's settlement terms, a cash settlement/minimum transfer amount memorandum and other related information.

[37] It resolves these issues by adhering to the standard of "commercial reasonableness." See ISDA Credit Derivatives Determination Committees Rules (11 July 2011), Rule 2.5(b): "DC Resolutions" (Each DC Voting Member shall perform its obligations under the Rules in a commercially reasonable manner in Resolving a DC Question and shall base its vote on information that is either public or can be published). This of course begs the question whether this is an objective or subjective standard. Consider the example of SEAT Pagine Gialle, an Italian telephone directories and street maps publisher, active also in the online advertising sector. On 28 November 2011 the EMEA DC had a very hard time deciding whether a failure to pay credit event occurred with respect to that company meaning that those who had bought protection would get a big payout from those who had sold it to them. 8 members (including Bank of America Merrill Lynch, Barclays, Credit Suisse, Deutsche Bank AG and Morgan Stanley among other) voted that it did, but 7 other members (including Goldman Sachs, JPMorgan Chase Bank, N.A., BNP Paribas and Société Générale) voted that it did not: http://www.isda.org/dc/docs/EMEA_Determinations_Committee_Decision_28112011.pdf . In the end, the payouts proved were worth some $465m in total. Luckily for the DC, the initially ambiguous situation was resolved by the company committing a more serious infringement on its debt. Lisa Pollack (FT Alphaville), 'The conflicted Isda committee', FT.com (14 December 2011) available at http://ftalphaville.ft.com/2011/12/14/799341/the-conflicted-isda-committee/ (accessed 19 November 2012). Admittedly, the case was complex. The Italian firm's bonds were issued by a Luxembourg-based special-purpose vehicle, which had a loan agreement with SEAT. When a payment was missed, there was debate over whether the grace period of the bonds - 30 days - should be applied to the loan (which would have otherwise have had a three-day grace period). But among the allegations concerning the bias was the fact that certain documentation that was not previously available suddenly surfaced. Chris Whittall, 'Dealers slam CDS committee', International Financing Review (9 December 2011) available at http://www.ifre.com/dealers-slam-cds-committee-'bias'/1619550.article (accessed 19 November 2012).

III. GAL AND PRIVATE POWER

GAL is an approach to global governance that emphasizes accountability. It has been defined in a by Kingsbury et al. as:

> comprising the mechanisms, principles, practices, and supporting social understandings that promote or otherwise affect the accountability of global administrative bodies, in particular by ensuring they meet adequate standards of transparency, participation, reasoned decision, and legality, and by providing effective review of the rules and decisions they make.[38]

Since it is the goal of the GAL project to define the unique properties of accountability in the context of global governance it does not define the term *ex ante*. But its open conception of accountability informed by descriptive accounts of accountability such as the one proposed, for example, by Ronald Oakerson – '[t]o be accountable means to have to answer for one's action or inaction, and depending on the answer, to be exposed to potential sanctions, both positive and negative.'[39] The focus of GAL is thus on evaluating global administrative bodies from the standpoint of their accountability. These bodies include (1) formal international organizations; (2) transnational networks of cooperative arrangements between national regulatory officials; (3) national regulators under treaty, network, or other cooperative regimes; (4) hybrid intergovernmental–private arrangements; and (5) private institutions with regulatory functions.[40]

Against the backdrop of this analytical outlook two things become immediately apparent. First, GAL is predominantly concerned with institutional or organizational arrangements in global governance. Accordingly, GAL scholarship develops rules and procedures that can help ensure the accountability of global administration, and it focuses in particular on administrative structures, on transparency, on participatory elements in the administrative procedure, on principles of reasoned decision-making, and on mechanisms of review. Second, the GAL approach considers at least some private bodies to be essentially functionally equivalent to public ones. Accordingly, it is argued that private regimes should conform to at least some of the same requirements that apply to public ones, most importantly in terms of accountability. It is argued that, domestically, private actors often assume

[38] Kingsbury et al, 'The Emergence' (n 18), 17.
[39] Oakerson, 'Governance Structures' (n 5), 114.
[40] Kingsbury et al., 'The Emergence', (n 18), 20.

regulatory functions, but many of them under structures of delegation from public bodies, and all are embedded in an order in which public bodies, both administrative and legislative, possess relatively effective means of intervention to control or correct private governance.[41] In the global context, such a public order is largely lacking, and yet private bodies perform tasks with far-reaching consequences, often spurred by the absence of effective public regulation: as a result, mechanisms should be constructed in the global administrative space that address the realities of the roles played by private bodies.

What is the justification for considering public and (some) private bodies as functionally equivalent? Kingsbury suggests that whereas non-state norms and structures often originate as amorphous regimes of private ordering, they can have distributive consequences and do not exclusively regulate relations between private parties. As he puts it: 'they often can be understood as beginning with private ordering,' but ultimately they advance:

> towards a conception of the public and of public law. Indeed, many of the central issues are about the interaction between formally public institutions and officials – and the unofficial practices. The unofficial practices are dubbed "private orderings" but in many cases they are not simply private. It is in their linkages that global administrative law operates.[42]

Two basic dimensions of accountability can be identified in the GAL literature: procedural and substantive. Procedural accountability refers to some of the core principles associated with the GAL approach - on administrative structures, transparency, participatory elements in the administrative procedure, principles of reasoned decision-making. At the same time, GAL also suggests that accountability in global governance is also a matter of the possibility of having the decisions made by global administrative bodies effectively reviewed. I will refer to this second dimension as substantive accountability.

IV. GAL AND ISDA

ISDA falls into GAL categories of global administrative bodies, specifically those that deal with banking and financial regulation. It is a private association formed by some of the most influential financial institutions in

[41] ibid, 54.
[42] Benedict Kingsbury, 'The Concept of "Law" in Global Administrative Law' (2009) 20(1) EUR. J. INT'L L. 1, 21, 31-33.

the world and it exercises a tremendous influence over the shape of derivatives markets across the globe through its interactional and constitutive powers. The next three subsections examine both the procedural and substantive dimensions of ISDA's accountability focusing in particular on the composition of the CDCs and the effects of close-out netting. The justification for this inquiry is to be found in the recognition that ISDA's power manifests itself both in the development of conventions for the derivatives market and in determination of social capacities and interests through quasi-administrative functions of the DCs.

1. Procedural accountability: representation and transparency

A number of problems related to ISDA's prominence and quasi-monopoly in setting, monitoring, and to a certain extent enforcing the rules for the market have been pointed out in the literature. In a 2007 article Frank Partnoy and David Skeel expressed a concern that ISDA may develop standardized documentation and approaches that benefit ISDA members at the expense of others, either because they redistribute resources among parties, create or take advantage of informational asymmetries, or create negative externalities.[43]

The operation of the CDCs is illustrative of this problem. The CDCs are composed of ISDA members who, in essence, have the biggest positions in any CDS contract under examination and as such are not independent bodies, neither institutionally nor in terms of the rules that they are bound to apply. At the same time, their decisions affect all CDS holders.

ISDA invokes several arguments in defense of the current structure of the DCs. First, it argues that the workings of the DCs are transparent, because both the rules of the DCs and the votes cast are made publicly available. Moreover, it is argued, most of the time, the decisions of the DCs are incredibly straightforward and pose little controversy. Thirdly, everyone in the industry signed up to the Big Bang Protocol, which gave the DCs the powers that they have. In other words, ISDA suggests that the DCs are a voluntary and representative mechanism. But as Lisa Pollack of the *Financial Times* points out, these are not necessarily meaningful benchmarks of transparency and legitimacy: 'Wouldn't true transparency mean that DC members disclosed the financial interests of their firm and their votes? Wouldn't it be refreshing to see them vote against their own position? Admittedly the benefit of the doubt would then have to be given to those

[43] See Partnoy and Skeel Jr, (2007) 'The Promise' (n 3).

who voted in the direction of their firm's interest'.[44] She finds the ISDA's two other arguments equally unpersuasive, suggesting that the legitimacy of a governance arrangement may be better tested in "hard cases" and that not signing the Big Bang Protocol was hardly a choice for most market participants.[45]

The conflicted nature of the DC mechanism is mitigated in situations in which the 80% threshold required for a DC decision is not met,[46] and the decision goes to external review. The external review panel is composed of individuals who have earlier been selected to be pool members in a region. The panelists are then selected by members of a convened DC for the same region and screened for potential conflicts of interests.[47] Five panelists must be selected by a unanimous vote of a DC. According to ISDA, the robustness of the review process derives from its reliance on independent, third-party professionals with market and/or legal expertise (such as British Queen's Counsels, academics, and other independent legal experts who specialize in the derivatives market). External review involves formal arbitration-style

[44] Lisa Pollack (FT Alphaville), More on the conflicted Isda committee (14 December 2011) available at http://ftalphaville.ft.com/2011/12/14/799741/more-on-the-conflicted-isda-committee/ (accessed 20 November 2012).

[45] ibid.

[46] 'This high level of consensus safeguards against either protection buyers or protection sellers unilaterally making a determination as a single block. Similarly, to address concerns that dealer members may all be on one side of the market with respect to a given issue, the threshold is high enough to ensure that dealer members cannot reach a decision by 80% supermajority without the support of at least two non-dealer members. In practice, there have been no dealer vs. non-dealer voting splits.' ISDA, The ISDA Credit Derivatives Determinations Committees (ISDA material on file with author).

[47] 4.3 Composition of the External Review Panels

> (a) Conflicts. Upon the existence of an Eligible Review Question, any Convened DC Voting Member may identify any Pool Member from the External Review Panel List for the same Region as such Convened DC for purposes of analyzing their availability and potential conflicts of interest with respect to such Eligible Review Question (each such Pool Member, a "Potential External Reviewer"). Each Potential External Reviewer shall notify the Convened DC, via the DC Secretary, by 5:00 p.m. Relevant City Time on the first Relevant City Business Day after being designated a Potential External Reviewer or such other time as the Convened DC Resolves by a Majority, of its availability and disclose to the Convened DC any conflict of interest which exists or is foreseeable with respect to either the Reviewable Question or the related DC Questions which may be deliberated by the Convened DC. Any Convened DC Voting Member or Convened DC Consultative Member may also raise an existing or potential conflict of interest with respect to a Potential External Reviewer or may ask for additional information to be disclosed.

briefing and argument, with all written arguments made public. ISDA members can submit a brief in connection with the reviewed question.[48] The review mechanism offers much of what could be expected from an effective review mechanism of decisions of a global administrative law body and its application to a wider set of cases would enhance ISDA's accountability.

2. Substantive Accountability: Legislative and Regulatory Recognition

ISDA leadership of the industry on derivatives issues is perhaps most exemplary when the organization lobbies to have its rules – such as the close-out netting provision – recognized in relevant jurisdictions. As Annelise Riles observed in her study of derivatives markets:

> where the terms in ISDA's standardized documents conflict with the norms enshrined in national statutory or judge-made law, ISDA actively works to supplant or change the latter so that it conforms to the former. ISDA hires local lawyers to investigate discrepancies between the terms of ISDA documents and national law, and where necessary, to lobby national governments to change national law to either conform to the terms of the Master Agreement or explicitly declare the ISDA documents enforceable.[49]

In order to facilitate recognition of close-out netting, in 2006 ISDA released the Model Netting Act (MNA). The MNA is a model law intended to set out, by example, the basic principles necessary to ensure the enforceability of bilateral close-out netting, including bilateral close-out netting on a multibranch basis, as well as the enforceability of related financial collateral arrangements.[50] As of August 2012 at least 46 countries had adopted or were considering netting legislation, which by all standards is a rather remarkable success for an initiative of a private organization.[51]

It is through legislative recognition of ISDA's conventions that ISDA decisions are reviewed at the domestic level. At the same time, it is, arguably, only the case where the legislative debate is actually meaningful. A legislative debate is meaningful if it produces an outcome that is not a mere result of

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[48] See e.g. briefs submitted in connection with the CEMEX External Review, available online at: http://www.isda.org/dc/view.asp?issuenum=2009100901.

[49] Annelise Riles, 'The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State' (2008) 56 AM. J. COMP. L. 605.

[50] The MNA is available at ISDA's website under "Opinions", available at http://www2.isda.org/functional-areas/legal-and-documentation/opinions/ (accessed 20 November 2012).

[51] ibid, under "Netting Opinions - list by country."

legislators rubber-stamping whatever is put in front of them by those who have a direct interest in the outcome. Rather, a meaningful legislative debate should be informed by a comprehensive assessment of the effects that the adoption of a specific measure will have.[52] There is merit to the arguments that have been made before the 2008 crisis, that at least some of the consequences of legislative recognition of enforceability of close-out netting have not been sufficiently thought through and discussed. A more comprehensive discussion of the desirability and feasibility of developing an international instrument on the enforceability of close-out netting was recently initiated by the International Institute for the Unification of Private Law (UNIDROIT).[53]

Legislative recognition as an accountability check reaches its limitations, when certain norms become entrenched in multiple jurisdictions and their simultaneous modification may prove to be difficult. This is in fact what happened to close-out netting. Despite the modifications introduced to US, and later also European law, there existed a perceived risk on part of the regulators that some transactions may fall outside. As the Scott O'Malia put it:

> ...if a US financial group enters resolution, then Dodd-Frank would apply and a stay would be imposed on terminations by its derivatives counterparties – at least, those subject to US law. If that US company has traded

[52] UNIDROIT's initiative can be instructive in how to achieve a more meaningful debate about a regulatory standard, one which would ensure that legislative recognition of the standard is in fact a way in which ex post facto accountability is achieved. UNIDROIT has commissioned a study assessing the extent of legal risk arising out of situations involving cross-jurisdictional netting and identifying the causes of legal obstacles to the proper operation of netting agreements. Additionally, the study explores possible solutions and appropriate steps to take, if any. A detailed report from the sessions is available from UNIDROIT's website. http://www.unidroit.org/english/documents/2012/study78c/cge-01/cge-1-report-e.pdf (accessed 2 December 2012).

[53] As Partnoy and Skeel wrote back in 2007: 'Although we believe there are strong policy arguments that credit derivatives should be subject to the same substantive regulation as other economically equivalent instruments, such as bonds and loans, we recognize that such changes are unlikely as a political matter.' Partnoy and Skeel, 'The Promise' (n 3), 1047. See also Bolton and Oehmke, (2011) 'Should Derivatives' (n 4): '[W]hile derivatives are value-enhancing risk management tools, super-seniority for derivatives can lead to inefficiencies: collateralization and effective seniority of derivatives shifts credit risk to the firm's creditors, even though this risk could be borne more efficiently by derivative counterparties. In addition, because super-senior derivatives dilute existing creditors, they may lead firms to take on derivative positions that are too large from a social perspective.' See also David Skeel and Thomas Jackson, 'Transaction Consistency and the New Finance in Bankruptcy' (2012) 112 Columbia Law Review 152.

> with a UK counterparty under English law, however, then there is some doubt as to whether the stay would apply, potentially impeding the efforts of the US resolution authority to deal with the situation.[54]

Accordingly, ISDA working with 18 largest banks and the Financial Stability Board developed a Protocol that will 'impose a stay on cross-default and early termination rights within standard ISDA derivatives contracts between G-18 firms in the event one of them is subject to resolution action in its jurisdiction. The stay is intended to give regulators time to facilitate an orderly resolution of a troubled bank.'[55]

3. Substantive Accountability: Judicial Review

Another way through which ISDA's decisions can be reviewed is through judicial means. A case from the US Federal Court for the Southern District of New York concerning the ISDA MA can help illustrate the role played by judicial review in providing a measure of accountability for ISDA's power.

In the jointly administered bankruptcy case of Lehman Brothers Holdings International (LBHI) and Lehman Brothers Special Financing (LBSF) the New York Bankruptcy Court considered the effect of bankruptcy or insolvency on the rights of a non-defaulting counterparty under the close-out netting provision of the MA.[56] Recall that according to the express terms of the MA, following the occurrence and during the continuance of an event of default, the non-defaulting party is not required to terminate the ISDA MA, and it equally is not required to perform obligations under the ISDA MA. In essence, the non-defaulting counterparty does not have to make payments. Metavante, a counterparty in a number of swaps transactions, relied on this reading of s. 2(a)(iii) and withheld its payments.

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[54] Scott O'Malia, 'Comment: Solving the too-big-to-fail puzzle', Financial Times, (24 October 2014).

[55] ISDA, 'Major Banks Agree to Sign ISDA Resolution Stay Protocol' (14 October 2014), available at http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol (accessed 27 February 2015).

[56] *In re Lehman Brothers Holdings, Inc.,* Case No. 08-13555 et seq. (JMP) (jointly administered). The case concerned Metavante Corporation's interest rate swap with LBSF incorporating the terms of the 1992 ISA Master Agreement. LBHI was a credit support provider under the Master Agreement. LBHI's bankruptcy filing on 3 October 2008 constituted an Event of Default under the Master Agreement that entitled Metavante to terminate the swap. For a discussion of the case see Stephen H Moller, Anthony R G Nolan, Howard M Goldwasser, 'Section 2(a)(iii) of the ISDA Master Agreement and Emerging Swaps Jurisprudence in the Shadow of Lehman Brothers' (2011) 7 J. INT'L BANK. L. & REG.

However, due to the substantial period of time that had passed since the commencement of the US Debtors' bankruptcy cases, the Bankruptcy Court ruled that Metavante had waived its right to terminate the swap agreement under the applicable safe harbor provisions. The Bankruptcy Code's automatic stay on actions against the debtor and its prohibition against the enforcement of ipso facto clauses prohibited Metavante from enforcing s 2(a)(iii) against the US debtors. Metavante's reliance on New York State contract law for the proposition that failure of a condition precedent excuses a party's performance obligation was trumped by federal bankruptcy law.

The court noted that while the Bankruptcy Code does not specify that non-defaulting counterparties must act promptly after a filing in order to rely on the protection afforded by its safe harbor provisions, the legislative history of the Bankruptcy Code establishes that Congress intended only to shield parties to financial contracts from the systemic risk that would result from cascading losses due to a counterparty's bankruptcy filing. Because the degree of systemic risk that could result from a single filing diminishes over time, both this decision and existing precedent held that the safe harbor only protects actions that are taken reasonably promptly after the filing date.

While judicial review is an important means through which a measure of substantive accountability of private power can be ensured, it has to be pointed out that limitation of enforceability of contracts such as the ISDA MA has impact on the design of the entire market. Even if there may exist good commercial reasons that warrant a particular interpretation of contractual provisions, this same reason may not be applicable when the contract in question is a regulatory contract. It is essential that judges and decision makers more generally recognize that conventions developed by organizations such as ISDA have a special role and that by interpreting judges effectively alter the design features of particular markets.[57]

V. CONCLUSION

This paper explained how ISDA meets the requirements of accountability that may be deemed to be applicable to private organizations from a GAL perspective. At least two types of justice-like concerns have been articulated with regard to ISDA. First, over-representation of the so-called sell-side institutions (banks, dealers) within ISDA's governance structure. Second, the effects of the close-out netting provision of the ISDA Master Agreement, which privileges derivatives in bankruptcy. ISDA has undergone a tremendous transformation since its inception in the early 1980s, both in terms of its

[57] Cf Stephen Choi and Mitu Gulati, 'Contract as Statue' (2004) 104 Michigan Law Review 5.

organizational and professional culture and its inclusiveness and openness. It has expanded its membership, and became much more transparent. It can arguably be said to be evolving towards a conception of the public or 'publicness' that constitutes the normative benchmark of legitimacy in GAL literature. ISDA achieves its accountability through a combination of procedural GAL-like standards as well as legislative, regulatory and judicial recognition of the standards it develops. This model of accountability makes ISDA responsive to both cosmopolitan and national constituencies.